

Review of Internal Control Over Payroll Taxes
Report No. 00-08, March 30, 2000

This report presents the results of the Office of Inspector General's (OIG) review of internal control over payroll tax revenue.

Background

The Railroad Retirement Board (RRB) is an independent agency in the executive branch of the Federal government. The RRB administers comprehensive retirement-survivor and unemployment-sickness benefit programs for the nation's railroad workers and their families under the Railroad Retirement (RRA) and Railroad Unemployment Insurance (RUIA) Acts. At the end of fiscal year (FY) 1999, there were approximately 748,000 annuitants receiving benefits under the RRA. The RRB paid unemployment and sickness benefits to approximately 34,000 claimants during the year.

During FY 1999, the RRB collected approximately \$4 billion in payroll taxes from over 750 railroads and the approximately 255,000 workers in their employ. Over 98% of all tax payments were made electronically.

The United States Department of the Treasury (Treasury) collects and measures taxes paid under the RRA. Treasury periodically transfers taxes collected to the appropriate RRB trust fund and advises the RRB accordingly. The RRB collects all taxes payable under the RUIA directly from railroad employers.

The accounting section of the RRB's Bureau of Fiscal Operations (BFO) collects, records and coordinates information concerning tax revenue from a number of external and internal sources. The Federal Financial System (FFS) is the mainframe computer application that supports the agency's accounting and financial management activities.

As a Federal agency, the RRB prepares annual financial statements in accordance with the principles and standards prescribed by the General Accounting Office, the Office of Management and Budget and the Federal Accounting Standards Advisory Board (FASAB).

FASAB promulgates accounting standards for the Federal government. Their Statements on Federal Financial Accounting Standards (SFFAS) have been recognized by the American Institute of Certified Public Accountants as generally accepted accounting principles (commonly called "GAAP") for the Federal government.

Audits of the RRB's financial statements for FYs 1993-1998 cited the RRB's limited ability to verify the completeness of RRA payroll tax receipts collected and transferred by Treasury as an internal control weakness.

The RRB's strategic plan states that "we will ensure that trust fund assets are projected,

collected, recorded, and invested appropriately through an effective and efficient trust fund management program.” This audit speaks directly to this key area of agency performance.

Objective, Scope and Methodology

The objective of this review was to assess the adequacy of internal control over accounting for payroll tax revenue. This objective specifically included evaluation of the status of the previously cited internal control weakness related to verification of RRA payroll tax receipts.

In order to achieve our objective, we:

- reviewed the applicable laws and regulations;
- obtained an understanding of the basic revenue transactions;
- identified and tested applicable internal controls; and
- interviewed BFO management and accounting staff concerning applicable procedures.

This review was limited to an evaluation of internal controls designed to ensure the accuracy of agency accounting for payroll tax revenue under the RRA and the RUIA. We did not consider the effectiveness of these controls in relation to any other source of revenue.

This audit was conducted in accordance with generally accepted government auditing standards, as applicable to the objectives. Fieldwork was performed at RRB headquarters during September 1999 through January 2000.

Results of Review

Internal control over payroll taxes is generally adequate to ensure that the RRB’s financial statements will not be materially misstated. However, we identified weaknesses in internal control related to transaction authorization and implementation of FASAB standards applicable to recognition of tax revenue.

Following is a detailed discussion of our findings and recommendations for corrective action.

Accrual of Unpaid Taxes

Existing procedures are not adequate to ensure compliance with all applicable financial reporting standards.

The RRB prepares its financial statements on the accrual basis of accounting. (Under the accrual basis of accounting, revenues are recognized when earned, and expenses are

recognized when a liability is incurred. Accordingly, the agency's financial statements have historically included estimated accounts receivable for RRA and RUIA taxes. These receivables represent taxes on compensation earned during the fiscal year for which the actual tax payment due dates fall after the end of that year. The estimates included in the financial statement are based on agency experience.

SFFAS #7, "Accounting for Revenue and Other Financing Sources," specifically provides that payroll taxes should not be accrued based on estimated payroll. (Effective for reporting periods after September 30, 1997.) This standard calls for recognition of tax receivables only after the payment due date has passed and a formal assessment process has identified non-payers.

Accounts receivable should be recognized when a collecting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets through its established assessment processes to the extent the amount is measurable. . . Assessments are enforceable claims for which specific amounts due have been determined and the person(s) or entities from whom the tax or duty is due have been identified. (SFFAS #7, Paragraph 53)

The agency's draft financial statements for FY 1999 reported RRA and RUIA tax receivables of \$198.9 million and \$27.7 million respectively. These receivables relate to employment during FY 1999 for which the statutory tax payment due dates are in the next fiscal year. Accrual of these amounts is contrary to the provisions of SFFAS #7. We brought this matter to the attention of BFO management. As a result of our discussions, BFO eliminated those receivables from the FY 1999 financial statements prior to publication.

BFO has agreed to initiate discussion of new accounting standards with the financial statement auditors as part of their implementation procedures. Such discussions are intended to facilitate timely identification of provisions that could impact the RRB's financial statements. OIG auditors and BFO management are already planning discussions to address recently released FASAB standards. Accordingly, we have made no additional recommendations for corrective action.

Voucher Authorization

Existing internal controls are inadequate to prevent the processing of unauthorized transactions by the FFS system. Controls designed to ensure that only authorized transactions are processed are a fundamental part of ensuring the integrity of a financial accounting system.

Under current procedures, the responsible BFO staff accountant prepares a written voucher and submits the paper document for approval to the senior accountant prior to entering the data into the FFS System. The accountant who prepared the voucher then

enters the transaction into the FFS system. The approved supporting documents are filed.

The approval of a paper document will not prevent unauthorized transactions from being entered into the FFS system and processed to completion. The FFS system includes a built-in control that, when operational, requires on-line authorization of previously entered transactions prior to processing. However, that control has not been activated.

Recommendation

We recommend that BFO implement on-line authorization of FFS transactions using the automated control that currently exists in the FFS system.

Management's Response

Although BFO management believes that existing controls are adequate, they have agreed to implement the on-line authorization feature of FFS as recommended by the OIG.

Verification of RRA Tax Receipts

The RRB has developed internal control techniques intended to "ensure that the Treasury accurately credits railroad retirement tax deposits to the railroad retirement trust funds." We have concluded that existing controls are sufficient to discharge the agency's financial accounting responsibilities in this area.

Audits of the RRB's financial statements for FYs 1993-1998 cited the RRB's limited ability to verify the completeness of RRA payroll tax receipts collected and transferred by the Treasury as an internal control weakness. However, based on our current assessment, we have concluded that, effective with the FY 1999 financial statement reporting cycle, the previously cited internal control weakness no longer exists.

During FY 1999, electronic tax payment systems provided a greater volume of high quality data than was available in prior years. This improvement in data availability has increased the value of the periodic tests that BFO performs to verify the reasonableness of payroll tax transfers from Treasury.

In addition, SFFAS #7, "Accounting for Revenue and Other Financing Sources," recognizes that, in the Federal government, the responsibility for collecting and measuring tax revenue may not reside with the entity that ultimately receives the funds. In the present case, the RRB, as a recipient of taxes collected by the Treasury, must rely on that agency to measure the amounts received and credited to agency trust funds.

Based on the foregoing, we have determined that current procedures are sufficient to ensure the reliability of financial reporting for RRA payroll tax revenue.